RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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October 10, 1979 **SPECIAL LETTER 767**

Sept. 28, DJIA 878.58; PTI 1137; A-D ratio –17.08
Oct. 5, DJIA 897.61; PTI 1149; A-D ratio –16.69

THE PICTURE: This Letter is a special (and late, for which I am truly sorry) because I just scrapped a beautiful 8-page Letter that was printed and ready to go. Let me clarify that statement–I didn't scrap it, the market did.

On October 9 the D-J rendered the first part of a 3-part bearish progression, a progression which I outlined carefully in the last page of the preceding mailing. What has happened? It's simple and clear enough. On October 9 the D-J Industrial Average broke its September low of 866.13. The D-J Transportation Average confirmed by breaking below its own September low of 257.40. And to make matters complete, the D-J Utility Average dropped below its September 20 of 105.51.

It all happened on almost record volume of 55 million shares. The breadth on the downside was incredible, 73 issues up and 1868 down! I don't think I remember a worse all-around day, but there were probably some back in the early 1930's.

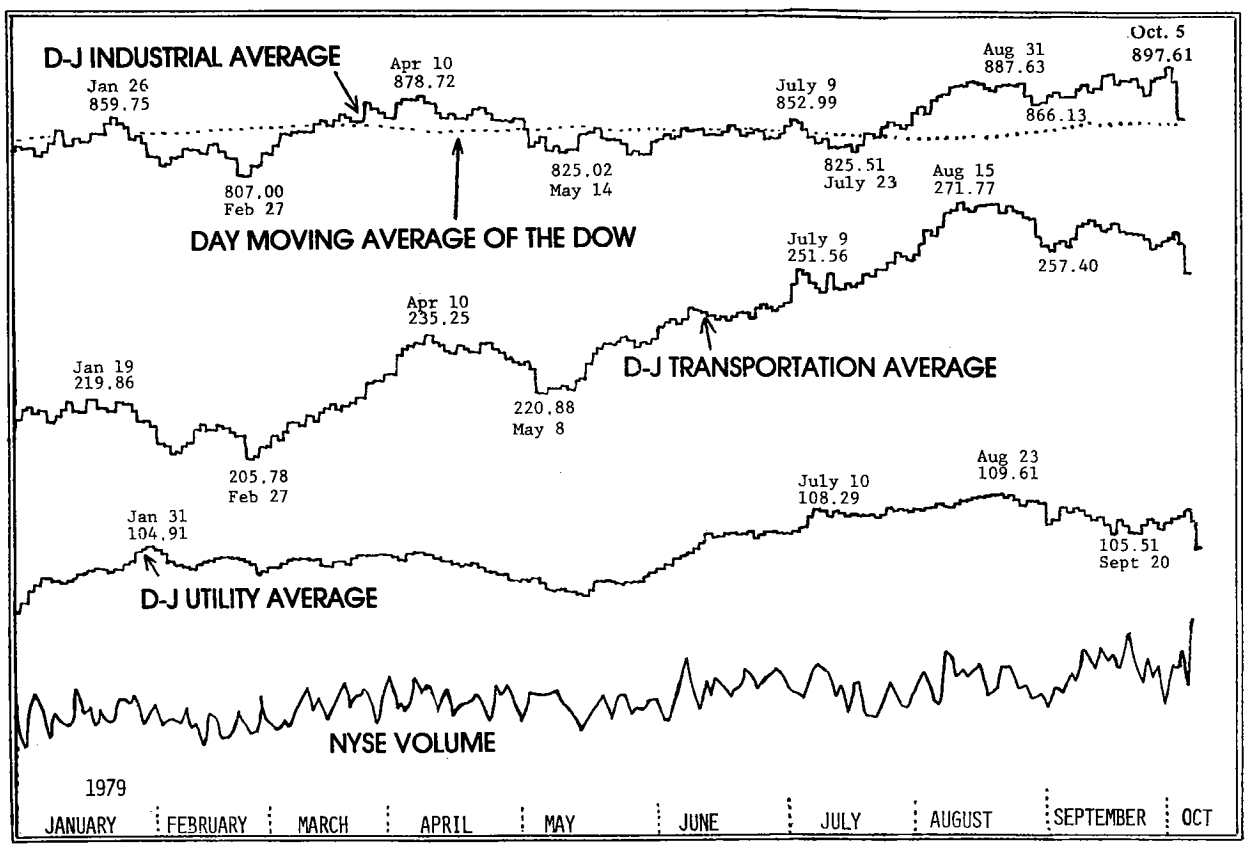
Gold on October 8 went down almost the limit, in reaction to the jump in the discount rate to 12% (the commodity limit is now $25 in gold). Then, to add insult to injury gold went up the limit on October 9, and the dollar, despite a fantastic jump in US interest rates, actually closed wobbly.

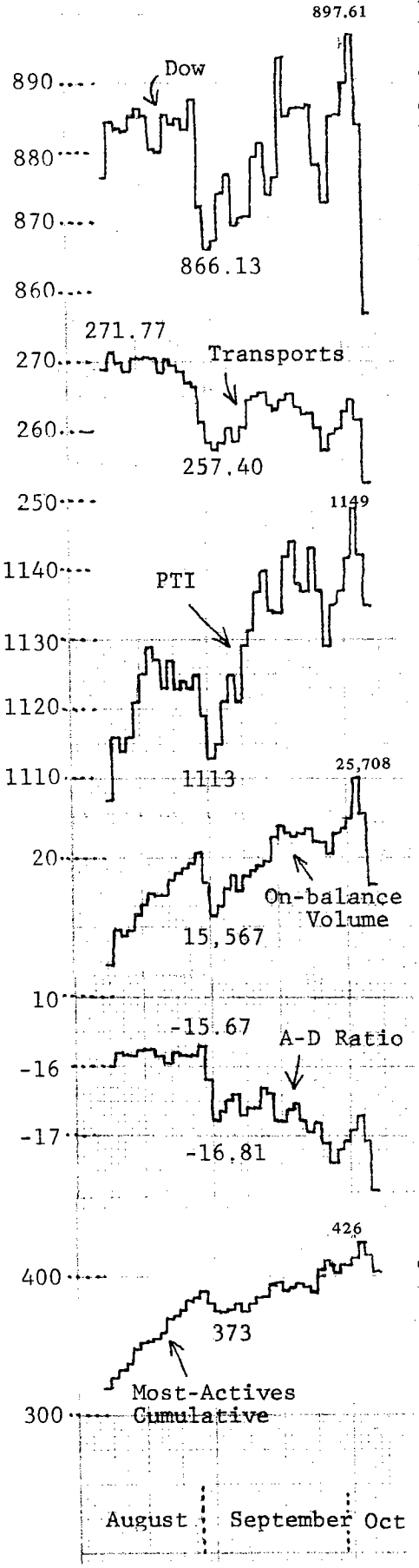
The 12% discount rate, in my opinion, now puts the Fed in a "box." If they hold the discount rate there and money tightens further, the economy could begin to come apart at the seams (as the prime rate moves up above the current 14.5%). But if the market panics further and the economy starts to buckle, the Fed will be over a barrel as to whether to start lowering the discount rate again. A lowering of the rate any time soon would indicate an unwillingness to "take the pain" and in that case the dollar would be in even worse trouble than it is now in.

The big question in my mind is, "What of the stock market, what is it telling us and where is it heading?" I really hesitated to write this "quick letter," because I don't like to change my stance unless I can say something of value. The truth is that I don't think there's a man or woman or group anywhere in the world who can tell us the full meaning of what we've just seen. The Primary Trend Index had just moved to a new record high of 1149 when the discount news hit. The PTI dropped 6 points on October 8, and a full 8 points on October 9. The PTI has now broken its shortest, steepest trend, but its main rising trend is still intact.

The downside market action had all the appearances of a full-fledged panic with the amazing October 9 figures of 720 thousand shares of upside volume on the NYSE to 54 million shares down! That was the most spectacular downside reading I have ever seen! I hope, moreover, that I never see it again. The AMEX Average on the 9th of October took its biggest drop in history. To sum it up, October 9 can be labeled "Black Tuesday."

I've seldom seen a market panic off a Dow ***peak*** as this one has done, but it's foolish to argue that "this or that doesn't fit"





the historical pattern. The fact that I'm going to emphasize is that the stock market did trigger ***my first bearish signal*** (even though it occurred on news), and that calls for cutting back on our limited commitments by 1/3 to 1/2.

The next potential bearish signal would be a Dow Industrial breaking of 848, which is the current level of its 200-day moving average. If the Dow smashes decisively below 848 I would suggest that 2/3 or all recent purchases be sold out.

As I explained in detail in the last Letter, the critical and final level for the market is 821-825 on the Dow. If the Dow plunges below that area, be totally out! There's no sense standing on the track and arguing with the Twentieth Century Limited. And if the 821 level is breached, it's my opinion that the bullish thesis will be in tatters.

The full meaning of any market movement is almost always obscure at the time it's occurring. The optimist can now opine that the smash of October 8-9 was set off by millions of stockholders all deciding to cash in some of their wares at the same time. There's no questioning the fact that many investors and traders have large paper profits and the thought of even higher interest rates set them to taking some of those profits. Consequently, the market exits got jammed. Under such herd-instinct actions, we could be nearer a bottom than a top.

The pessimist can say that all three Dow Averages broke significant preceding lows on October 9 and that such signals had best not be ignored. Furthermore, says the pessimist, the authority of the signal was underscored by near-record NYSE volume of 55 million shares. After such a performance, adds the pessimist, "it's every sane investor into the life-boat, and never mind the why's and wherefore's."

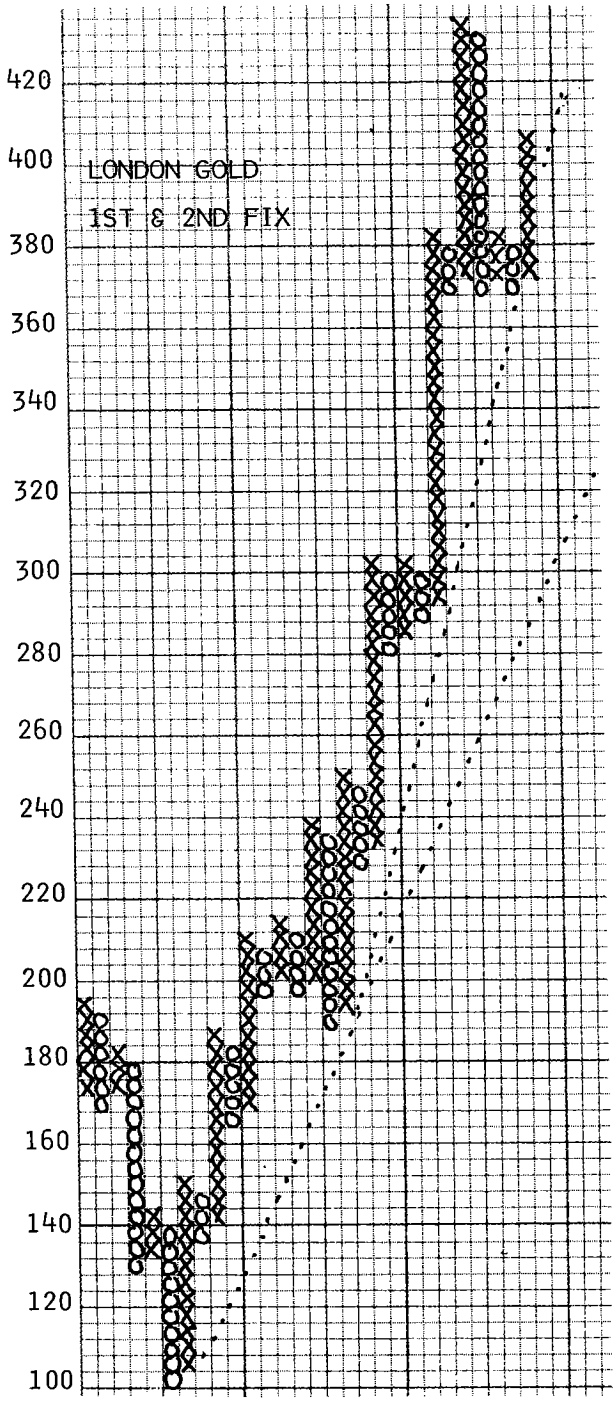
My own feeling is that my three bear levels are indeed the correct ones and the ones I want to stay with. I suggest therefore, that subscribers re-read Letter 766 and more particularly the special Addendum in that mailing.

One of my guiding principles throughout the 21 years that I have been writing this Letter is that the protection of capital comes BEFORE ALL ELSE. Small losses are acceptable in this business but a major loss of capital is a disaster. Those who are not willing to pay the price of insurance by taking small losses will, sooner or later, be fated to ride through a Wall Street hurricane. This is the fatal mistake of many investors, a mistake from which few ever fully recover.

I am including a composite chart of 6 Averages and indicators which I follow. They are shown from the period of August 14 to the present, and the chart is practically self-explanatory. The clear break and warning signal of the D-J Industrials and Transports is shown. The still resistant PTI is there to see. NYSE daily on-balance volume is still holding above its early-September low, but the A-D ratio has taken a severe drop and the Dow has confirmed the A-D break. Lastly, the cumulative index for the 15 most-actives on the NYSE is still near its high. This index, together with the PTI, has been the strongest and most bullish indicator in the market.

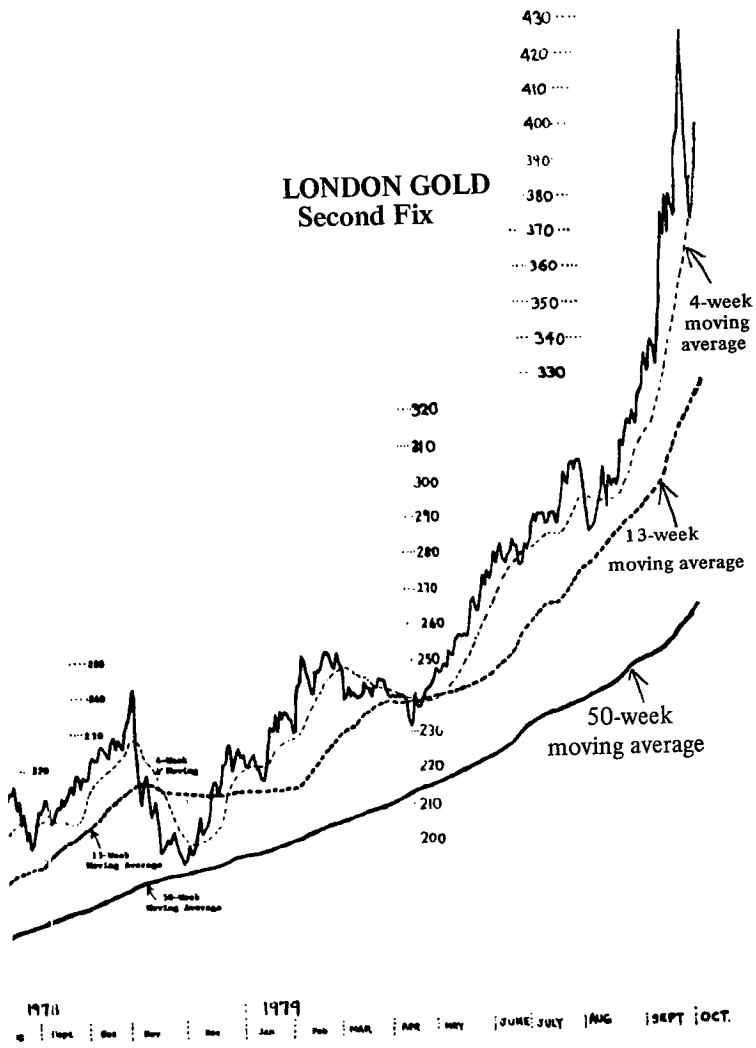
I am now watching the PTI with intense interest–to see whether it holds or breaks below its September low of 1113. But I'll repeat the message of this Letter once more–the first danger signal has been given by the market, and this signal calls for action. But at this point I cannot tell how serious the situation is and it would be dishonest of me to suggest that I can. Maybe I should put it this way: I worked hard all week on what I thought was a "marvelous" Letter–then scrapped it with the action of October 8-9. That was my instinct (the same one that wrote the last "Addendum") telling me that things just could be quite serious.

GOLD: "Gold, gold, you're making me old." I had a lovely 1 x 3 point and figure chart of gold that I used to show in this Letter. Then gold went over 250, and the price movement went off the top of the page. So I switched to a 2 x 6 chart, which means that each box on the chart represents 2 points (instead of the former 1) and only advances or declines of 6 points or more are shown (instead of 3 point advances or declines). But then gold went over 300, and the price action went off the top of the chart again. So I've now switched to a 4 x 12 chart, and on this chart each box represents 4 points and only moves of 12 points or more are shown!



The chart reads quite simply. It all started back in 1976 where you see that great head-and-shoulder bottom pattern formed. The price movement since then has been walking up and inside of a rising trendline, and that trendline has never been endangered. A steeper rising trendline has now been touched, however, and it's possible that this latest trendline will be ruptured soon.

Note also that gold has formed a somewhat toppy looking structure, which could (in retrospect) prove to be a head-and-shoulders top. A price break down to the lower 360's (say 362) would be required to turn this pattern bearish. In the meantime, if you're trading gold on the commodity markets, you're a better man (with a stronger stomach) than I am. If you're still hanging onto your coins, then you're showing good paper profits for all that sweat and prayer. The metal markets and the currency markets are so wild, so violent and erratic that it's getting so you can't sleep if you don't have gold, and you can't sleep if you do have it.



The daily chart of gold and its 3 moving averages is also instructive. Here we see gold coming down and touching its 4-week moving average which now stands at about 378. It's been an unprecedented 6 months since gold has corrected by connecting with its 13-week moving average. That indicator is now at 322. The primary or 50-week moving average for gold is at 265, and you can see that the 13-week MA has been pulling away from the 50-week MA ever since last May. It's an extraordinary chart, and rather frightening if you happen to believe that gold is real money and that rising gold means declining paper currency, regardless of the rate of interest that paper money offers to the holder.

Conclusion: In view of the boiling and erratic current gold market I feel that only one type of gold holding is warranted–and that is the holding of gold coins on a diversification (plus "survival") basis. This should be in the proportion of about 15% of one's assets. I know that there are some advisories who are advocating 50% and even 100% of your assets in gold. Maybe so, but I have to sleep nights, and moves of $20 down and $30 up are too much for me. I'll tell you the truth, I liked it better when gold was 50 to 60 an ounce, and the whole thing was a gentleman's game.

NEXT MAILING: October 24th